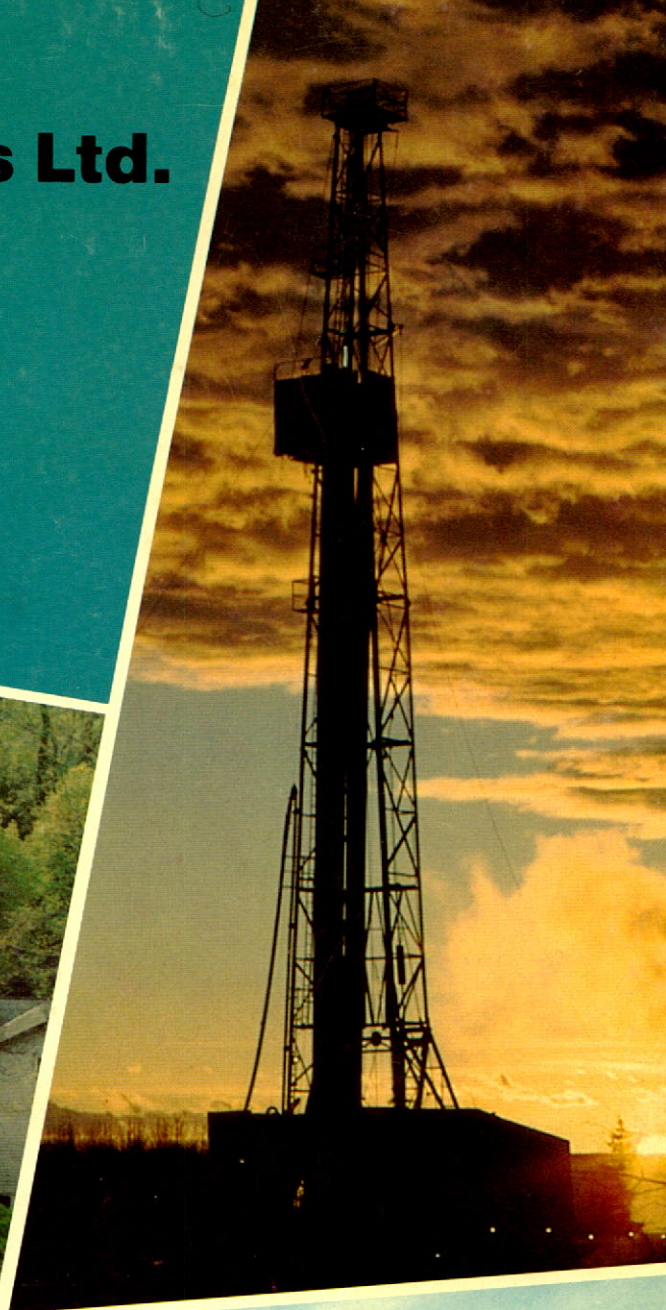




Bow Valley Industries Ltd.

**ANNUAL
REPORT
1978**



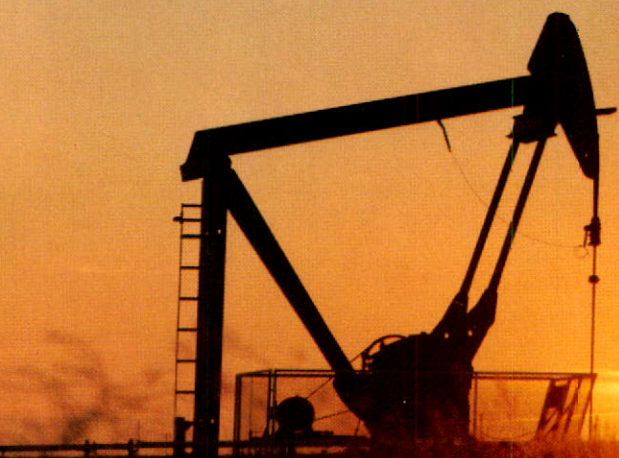
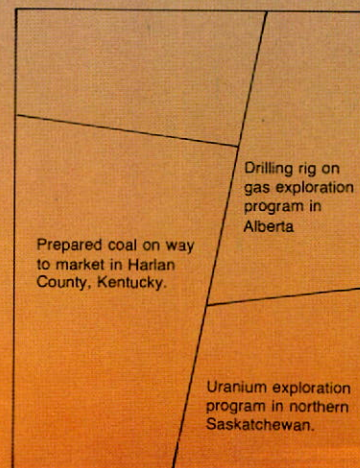
Financial Highlights

	1978	1977
Revenue	\$174,725,000	\$131,715,000
Cash Flow	\$ 29,124,000	\$ 13,972,000
Per Common Share	\$ 6.01	\$ 2.89
Net Income	\$ 10,889,000	\$ 4,778,000
Per Common Share	\$ 2.13	\$ 0.87
Average Shares Outstanding	4,843,004	4,833,725
Capital Expenditures	\$186,035,000	\$ 34,479,000
Working Capital	\$ 11,489,000	\$ 11,223,000

Bow Valley Industries Ltd. is a resource-oriented company that was incorporated under the laws of the province of Alberta in 1950. The activities of Bow Valley are conducted under two operating entities.

- Bow Valley Exploration is engaged in international exploration and development of oil, gas, coal and uranium.
- Bow Valley Resource Services Ltd. provides service and manufacturing facilities to the natural resource industry.

THE COVER



Report to the Shareholders

HIGHLIGHTS

Fiscal 1978 was a year of extraordinary achievement for Bow Valley:

- Net income, cash flow, and capital investments reached record levels.
- The common dividend was increased.
- Flying Diamond Oil Corporation, a United States producer of oil, gas, and coal, was acquired for \$135,000,000.
- A significant uranium discovery was made at Midwest Lake in northern Saskatchewan.

FINANCIAL

Net income for fiscal 1978 was \$10,889,000, or \$2.13 per share, compared to \$4,778,000, or 87¢ per share, last year. Cash flow reached \$29,124,000, or \$6.01 per share, from \$13,972,000, or \$2.89 per share, in fiscal 1977. Revenue increased to \$174,725,000 from \$131,715,000. Bow Valley's capital expenditures, exclusive of acquisition costs, during fiscal 1978 were \$51,030,000. Working capital at the year end was \$11,489,000.

OPERATIONS

Both of Bow Valley's operating entities enjoyed excellent results in fiscal 1978.

BOW VALLEY EXPLORATION — had a cash flow of about \$18,000,000 and capital expenditures, exclusive of acquisition costs, of \$34,728,000.

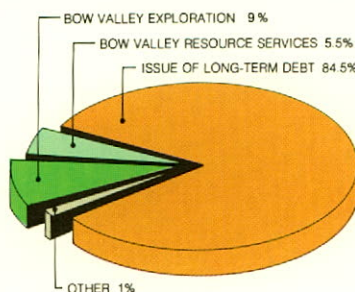
Oil and Gas

During fiscal 1978, oil and gas revenue increased because of higher production and improved selling prices.

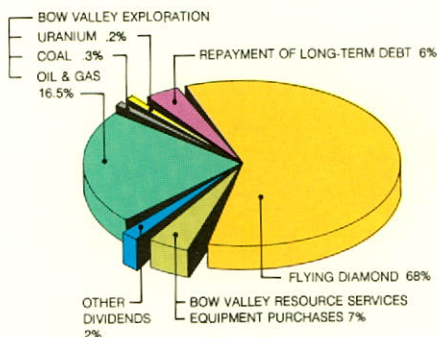
Oil and gas production averaged 2,456 barrels of oil and 57,600 Mcf of gas per day respectively.

Comparative figures in 1977 were 1,689 barrels of oil and 43,389 Mcf of

SOURCE OF FUNDS



APPLICATION OF FUNDS



gas. Proven reserves at May 31, 1978, increased to 19 million barrels of oil and 414 billion cubic feet of gas from 12 million barrels of oil and 286 billion cubic feet of gas a year earlier.

Exploration and development continued at a high level in all operating areas. The acquisition of Flying Diamond in January 1978 gave Bow Valley the opportunity to become immediately established throughout the United States, one of the world's largest energy markets.

Overseas, successful appraisal drilling in the North Sea continued at Brae and construction of the Arzanah production facilities in the Arabian Gulf progressed on schedule. Offshore Viet Nam, Bow Valley is negotiating to participate in an exploration program in the South China Sea.

Coal

In the Flying Diamond acquisition, Bow Valley acquired a substantial bituminous coal mining operation in Harlan County, Kentucky. Recoverable reserves at May 31, 1978, were 27,439,000 tons and have been increased by a subsequent purchase of another 7,000,000 tons. Current production is 1,250,000 tons per year which will be increased to 1,850,000 tons per year by 1980. A majority of the production is sold under long term contracts to two major utilities.

Uranium

A core hole drilling program at Midwest Lake in northern Saskatchewan has located a uranium ore body over 4,000 feet in length with an approximate width of 275 feet. The average uranium content has been 37.5 pounds per ton. Considerable coring and detailed geological and engineering studies must be completed before a decision on commercial development can be made, but results to date are encouraging.

BOW VALLEY RESOURCE SERVICES LTD.

— had a cash flow of about \$11,000,000 and invested \$16,302,000 in equipment purchases, excluding the acquisition of six oilwell drilling rigs in the Appalachian region of the United States. All of Bow Valley's service and manufacturing operations reported improved results except the Diamond Drilling Group, which was adversely affected by continuing depressed conditions in the mining industry.

PERSONNEL

As at May 31, 1978, Bow Valley had 2,565 employees in Canada, the United States, and overseas. From the well-managed coal operation in Kentucky to the efficient oilwell drilling crews in Alberta, Bow Valley is fortunate in having an excellent work force and capable management to supervise its diversified operations.

During the year, Mr. H. Donald Binney retired after 39 years with Bow Valley and its oilwell drilling predecessor companies. Mr. Binney was a Director and senior officer for many years and was acknowledged as an expert in his field. Major General Lord Michael Fitzalan Howard has elected to resign as a Director of Bow Valley because of personal commitments in the U.K. Lord Michael has agreed to serve, however, as Chairman of the U.K. subsidiary company, Bow Valley Exploration (U.K.) Limited. Bow Valley wishes to express appreciation and thanks to both retiring Directors.

OUTLOOK

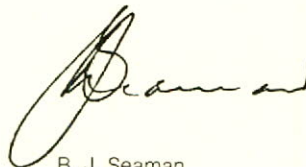
Bow Valley is in the process of changing its year end from May 31st to December 31st and will report for the seven months ended December 31, 1978. A continuation of favourable operating results is expected. The policy of reinvesting its cash flow and additional funds in the international resource industry has increased the asset value and earnings base of Bow Valley substantially over the past year, and we look forward to the future with confidence.



D. K. SEAMAN
Chairman and
Chief Executive
Officer

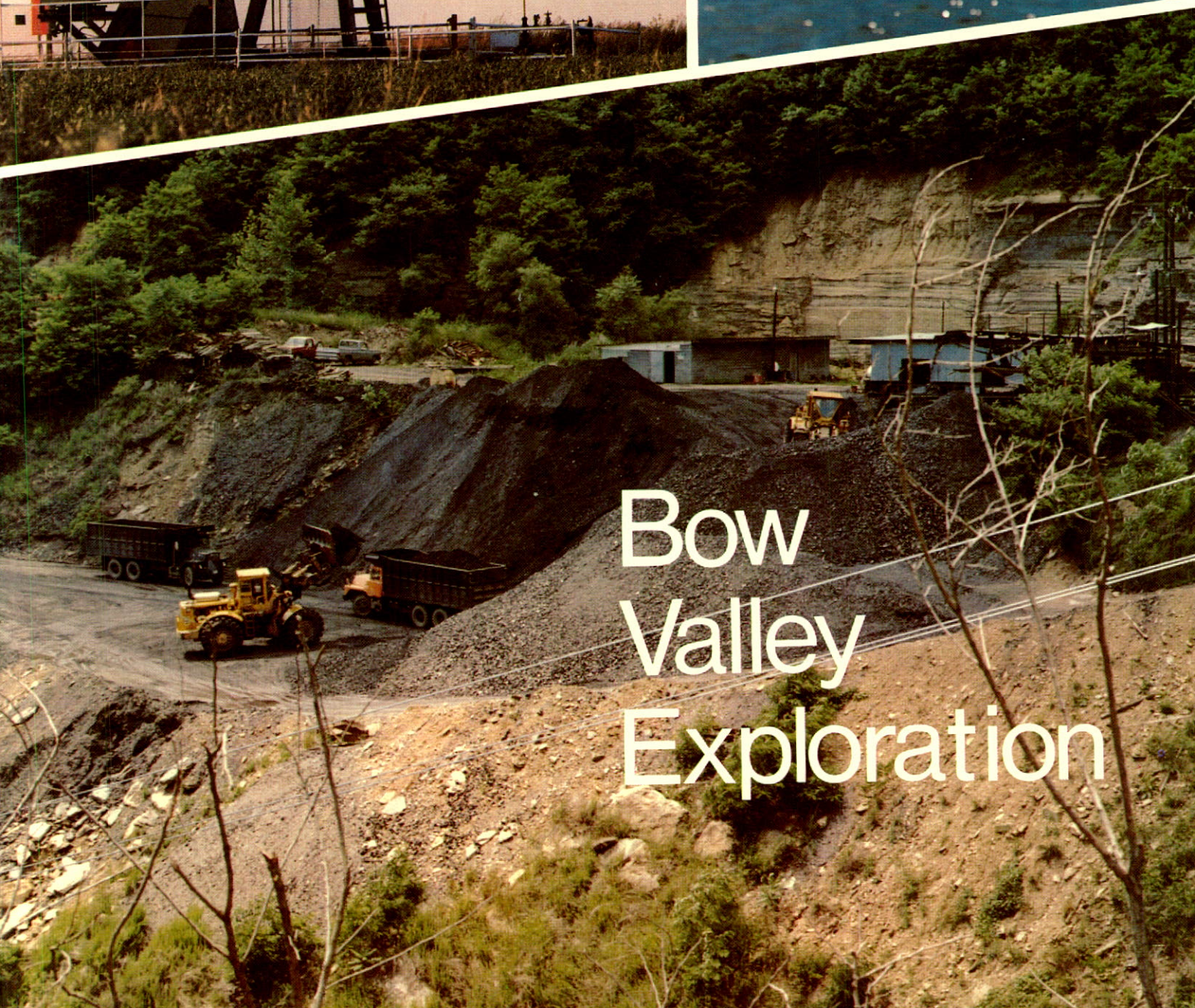


J. R. HARRIS
President and
Chief Operating
Officer



B. J. Seaman
Vice-Chairman

August 25, 1978



Bow Valley Exploration

Bow Valley Exploration

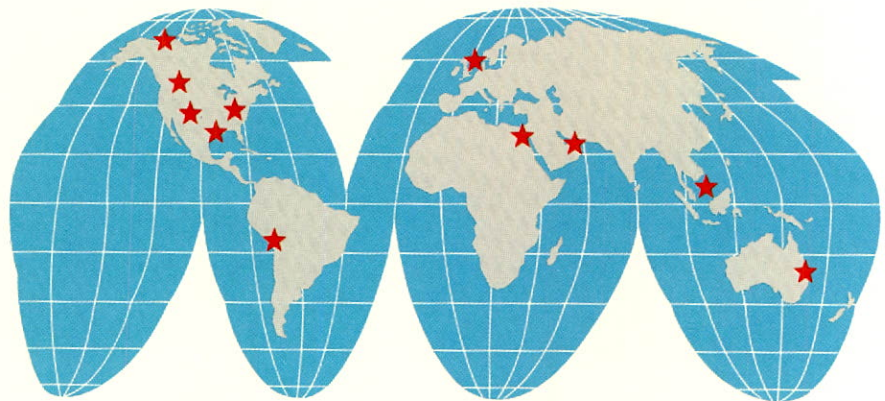
All exploration and development operations of Bow Valley Industries Ltd. are conducted by a division, Bow Valley Exploration. These operations are directed from offices in Calgary, Denver, London, and Singapore.

OIL AND GAS

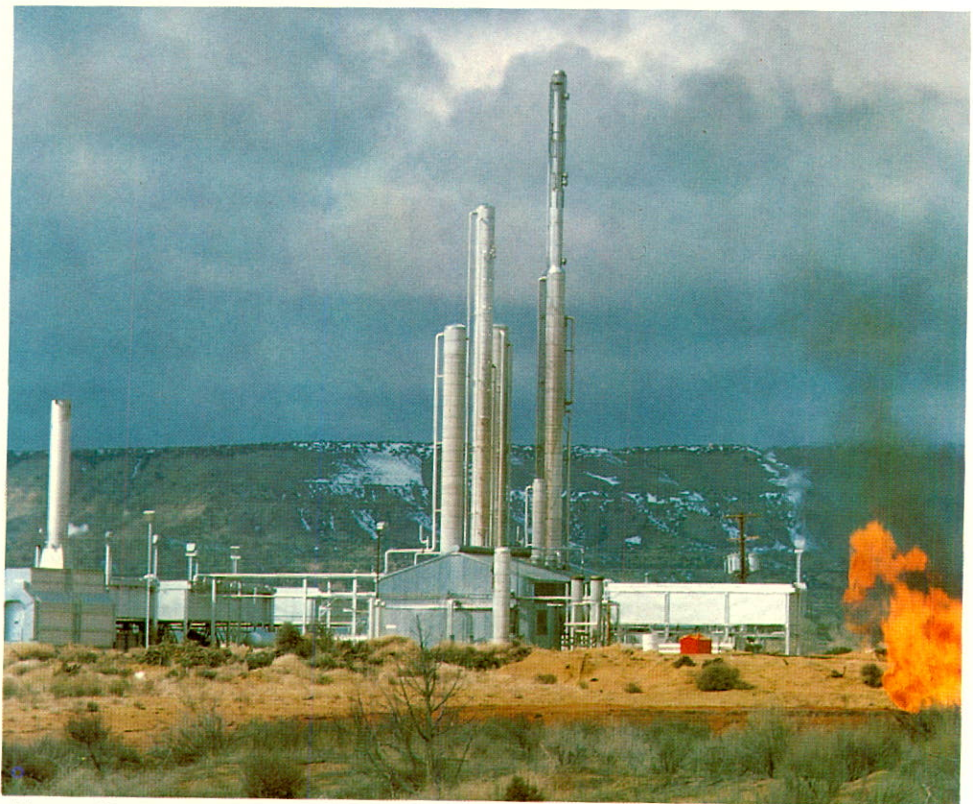
In fiscal 1978, Bow Valley invested \$33,989,000 in exploration and development and, in the seven months ending December 31, 1978, expects to spend an additional \$35,000,000 in the search for oil and gas reserves. Varying interests are held in 15,965,000 acres in Canada, the United States, South America, the North Sea, the Middle East, and Southeast Asia and Bow Valley now has interests in 2,689 oil wells and 1,062 gas wells. At May 31, 1978, Bow Valley owned, exclusive of any reserves at Brae, Heimdal, the Mackenzie Delta, or the Arctic Islands, 19,430,000 barrels of proven oil reserves, 414 billion cubic feet of proven gas reserves, and production in fiscal 1978 averaged 2,456 barrels of oil per day and 57.6 million cubic feet of gas per day.

CANADA

In fiscal 1978, Bow Valley continued its development drilling program in the Wandering River area of Alberta and followed up on a number of other shallow gas prospects in the province. Bow Valley is the operator of two groups conducting deep seismic programs and lease acquisitions in northeast British Columbia and western Alberta. Drilling activity in these areas will be increased. These deeper projects represent a departure from Bow Valley's traditional area of activity in eastern Alberta where Bow Valley pioneered shallow gas drilling in the early 1960s; the recent large increases in gas production are a result of these programs. Emphasis is now being placed on drilling for deeper reserves where unexplored



★ BOW VALLEY'S WORLD-WIDE AREAS OF ACTIVITY.

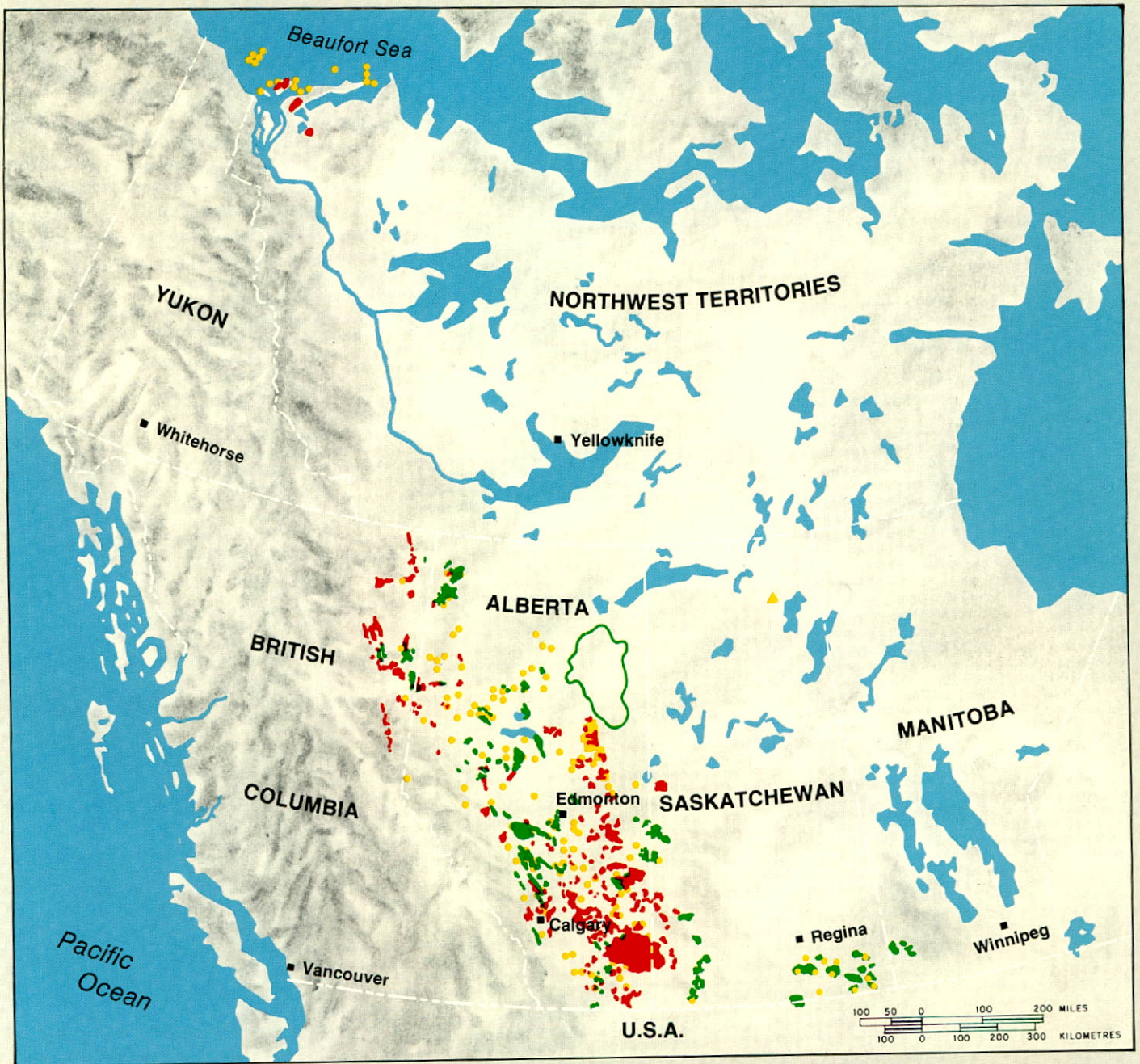


Altamont-Bluebell gas plant in Utah.

acreage is still available and the potential of discovering large reserves is promising.

Elsewhere in Canada, a successful appraisal well was drilled during the winter in the Mackenzie Delta on a permit in which Bow Valley has a 27.5 percent interest. Garry G-07 was drilled one and one-half miles north of the successful Garry P-04 and

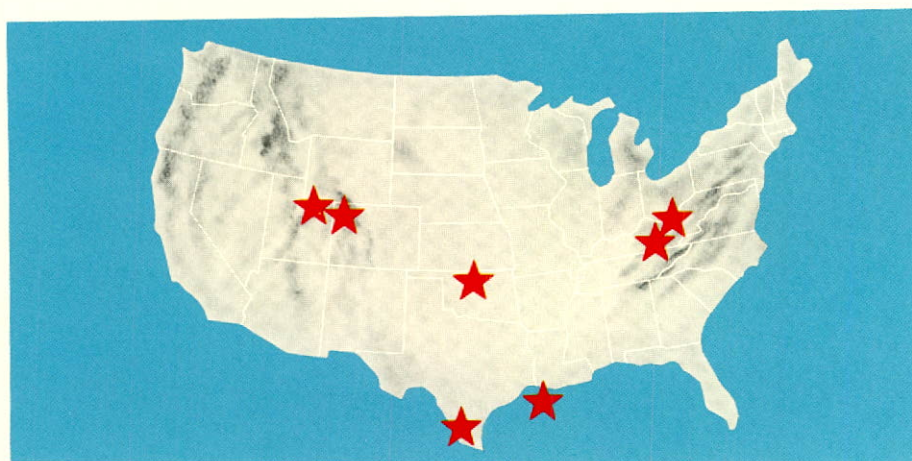
tested cumulative gas flows of 21.4 MMcf per day from two horizons. Further drilling in the Mackenzie Delta and Beaufort Sea will be dependent on the availability of future gas markets. Bow Valley also has a 1.9 percent interest in Panarctic Oils Ltd. which continues to actively explore for oil and gas in the Arctic Islands.



WESTERN CANADA and NORTHWEST TERRITORIES

- BOW VALLEY LAND HOLDINGS
- OIL FIELD
- GAS FIELD

Bow Valley Exploration



★ BOW VALLEY'S AREAS OF ACTIVITY IN THE UNITED STATES.

UNITED STATES

Early in fiscal 1978, Bow Valley drilled a number of wells in the Gulf of Mexico, Louisiana, and Oklahoma. Bow Valley's first foreign production sold to market occurred in January 1978 from an oil discovery in the Sooner Trend of Oklahoma but Bow Valley's U.S. operation increased substantially with the acquisition of Flying Diamond Oil Corporation of Denver, Colorado. Flying Diamond brought to Bow Valley an experienced exploration group and immediate participation in exploration and development projects in the Rocky Mountain and Appalachian basins, and a further interest in the Gulf Coast area. From this base, Bow Valley is now able to pursue a more active drilling program in the United States, one of the world's largest energy markets.

EUROPE, AFRICA, AND THE MIDDLE EAST

United Kingdom

On Block 16/7 in the North Sea, 13 wells have now been completed and have defined three separate reservoirs in the Brae field. Recent drilling activity in the field has been concentrated in the southern portion

of the Block to determine the extent of the South Brae reservoir discovered by Brae 16/7-8. This well encountered 1,220 feet of gross hydrocarbon section and tests of five separate intervals flowed oil at an aggregate rate of 33,122 barrels per day. Three appraisal wells, 16/7-10, 16/7-11, and 16/7-13, encountered a thick hydrocarbon section and tested oil at high rates, while 16/7-12 was only marginally successful but did define the western limit of the reservoir. The results of 16/7-13 were announced on August 16, 1978: five tests flowed oil at an aggregate rate of 19,618 barrels per day.

Appraisal drilling has now been completed in South Brae and the interpretation of the final technical data is proceeding. A decision should be made shortly on a specific plan to proceed with the installation of production facilities on South Brae. In due course, appraisal drilling on Central Brae, discovered by 16/7-3, and North Brae, discovered by 16/7-1, will commence preparatory to development.

Bow Valley's share of all costs continues to be paid by Ashland Oil, Inc. and The Louisiana Land and Exploration Company under the 1976 agreement. Bow Valley retains a 14

percent interest in Blocks 16/3 and 16/7, and a 17.5 percent interest in Block 16/2. Seismic information indicates interesting structures on both Blocks 16/2 and 16/3, which may be drilled in the near future.

Norway

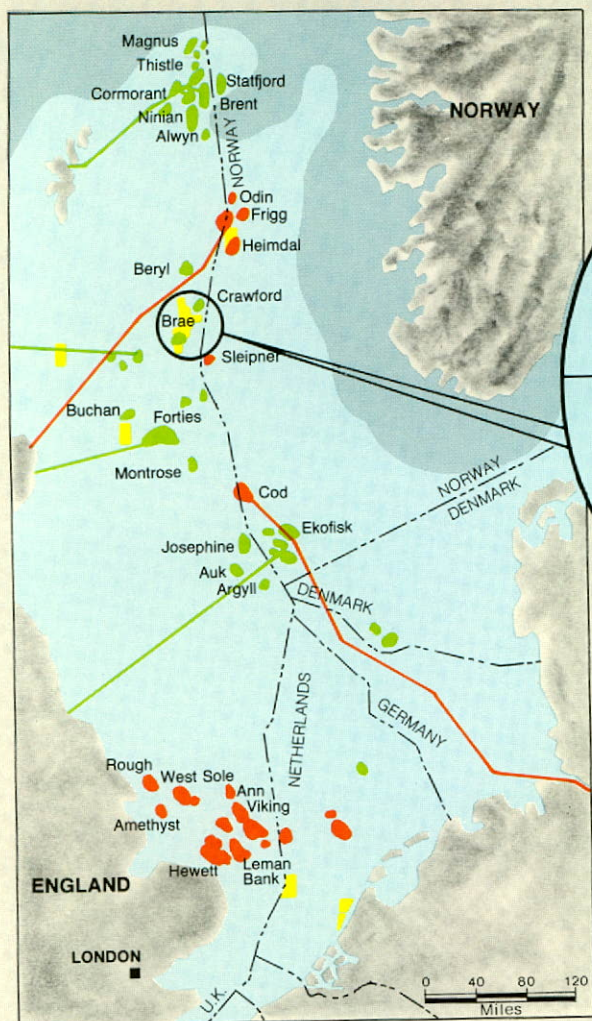
There were two important developments in fiscal 1978 involving the Heimdal gas and condensate field in the Norwegian sector of the North Sea:

- The Frigg field went on production during September 1977. Frigg is a major gas field only 20 miles north of Heimdal, and it is anticipated that Heimdal gas, under contract to the British Gas Corporation, will be produced through the Frigg system, which is performing to expectations.
- In April 1978, the Norwegian government publicly announced incentive proposals to encourage the development of small offshore fields and specifically mentioned Heimdal. Bow Valley attended a meeting with the government in June 1978 to initiate discussions.

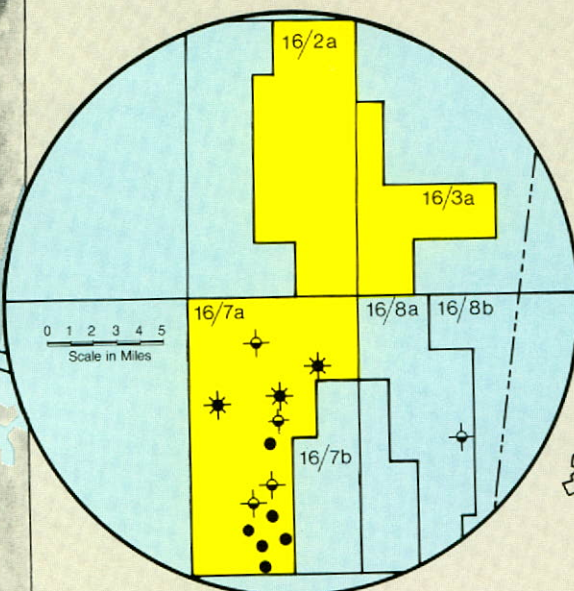
Further seismic studies or exploratory drilling may be necessary before production facilities are finally designed and constructed. Bow Valley has an eight percent interest in the field.

Abu Dhabi

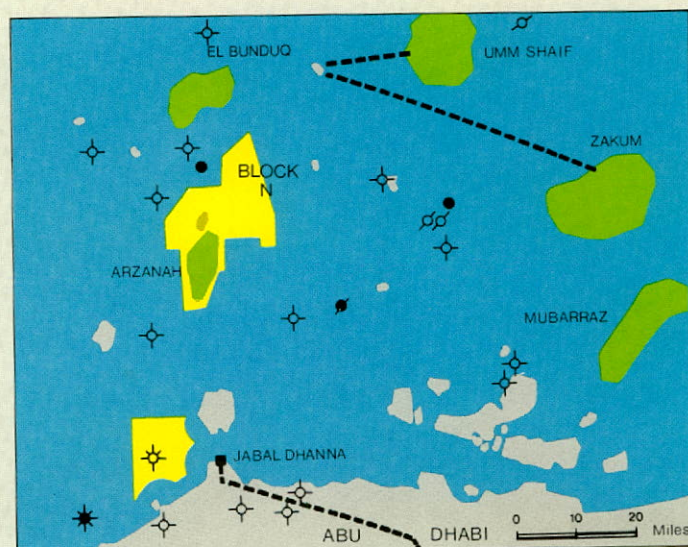
Offshore Abu Dhabi in the Arabian Gulf, the ninth well was successfully completed in the Arzanah oil field during fiscal 1978. Production facilities, both offshore and on Arzanah Island, are under construction and the cost of the project is now estimated to be \$185,000,000. Production should commence in June 1979 and will eventually reach 40,000 barrels per day. Proven reserves are estimated to be 80,000,000 barrels. Bow Valley is a 10 percent participant and project financing has been arranged for Bow Valley's share of the costs.



NORTH SEA



- BOW VALLEY LAND HOLDINGS
- OILFIELD
- GASFIELD
- OIL WELL
- OIL AND GAS WELL
- SUSPENDED
- OIL SHOW
- ABANDONED
- GAS SHOW



ABU DHABI

Bow Valley Exploration

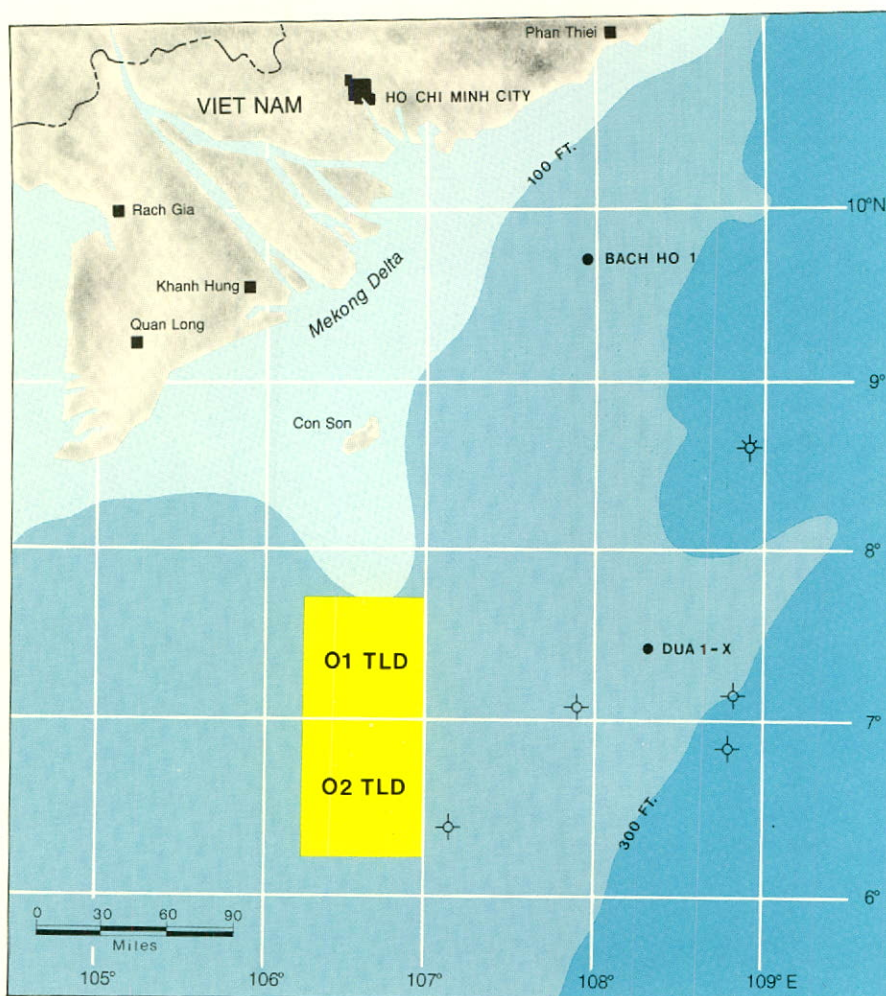
SOUTHEAST ASIA

Australia

During fiscal 1978, Bow Valley earned a 50 percent interest in a 3,168,000-acre onshore concession in New South Wales by drilling a 4,000-foot exploratory test. The well was abandoned and future exploration programs have not yet been formulated. Negotiations are continuing for the acquisition of additional onshore concessions.

Viet Nam

Negotiations are continuing whereby the Socialist Republic of Viet Nam may award to Bow Valley and other Canadian companies Blocks 01 TLD and 02 TLD in the South China Sea, approximately 200 miles south of Ho Chi Minh City. The minimum commitment on the project would be \$13,150,000 over a three-year period. Water depths in the 3,400,000-acre Blocks average 130 feet and drilling, if negotiations are successfully concluded, could commence in 1979. Extensive seismic programs have been completed and the area is geologically very promising. Bow Valley is the operator for the group and has a 30 percent interest.



VIET NAM Southeast Asia



- BOW VALLEY LAND HOLDINGS
- OIL WELL
- GAS SHOW
- ABANDONED WELL

Oil and Gas Summary — Fiscal 1978

(Before the deduction of royalties)

Developed and Undeveloped Acreage

As At May 31, 1978

	Gross	Net
— Canada (1)	4,974,389	1,160,094
— United States	645,755	276,632
— Europe, Africa, and the Middle East	4,539,341	439,564
— Southeast Asia	3,168,000	1,584,000
— Other	2,637,782	659,448
	<u>15,965,267</u>	<u>4,119,738</u>

Proven Reserves

As At May 31, 1978

	Oil/bbls	Gas/MMcf	Equivalent/bbls (2)
— Canada	6,713,685	278,876	53,192,941
— United States	8,661,665	135,149	27,406,325
— Europe, Africa, and the Middle East (3)	4,055,000	—	4,055,000
— Southeast Asia	—	—	—
	<u>19,430,350</u>	<u>414,025</u>	<u>84,654,266</u>

Production

	For The Year			Daily Average		
	Oil/bbls	Gas/MMcf	Equivalent/bbls (4)	Oil/bbls	Gas/MMcf	Equivalent/bbls (4)
— Canada	651,670	19,190	3,017,928	1,785	52.6	8,268
— United States (5)	245,059	1,818	443,433	671	5.0	1,215
— Europe, Africa, and the Middle East	—	—	—	—	—	—
— Southeast Asia	—	—	—	—	—	—
	<u>896,729</u>	<u>21,008</u>	<u>3,461,361</u>	<u>2,456</u>	<u>57.6</u>	<u>9,483</u>

Drilling Participation

	Drilled		Successful	
	Exploration	Development	Exploration	Development
— Canada	42	60	10	52
— United States	8	27	3	24
— Europe, Africa, and the Middle East	3	6	—	5
— Southeast Asia	1	—	—	—
	<u>54</u>	<u>93</u>	<u>13</u>	<u>81</u>

Notes

- (1) Excluding acreage owned by Panarctic Oils Ltd. As at December 31, 1977, Panarctic held working interests in 77,700,000 gross permit acres and 32,300,000 net acres. Bow Valley holds a 1.8626 percent interest, or 829,110 shares, in Panarctic.
- (2) Conversion factor used was 6.13 Mcf/bbl for Canadian reserves and 7.21 for United States reserves based on independent consultant's forecast of future oil, natural gas liquids, and natural gas volumes and revenues.
- (3) Assumes Bow Valley maintains 10 percent working interest in the Arzanah oil field offshore Abu Dhabi until recovery of capital investment, reducing to five percent thereafter to provide for the Ruler exercising his option to take 50 percent equity interest.
- (4) Fiscal 1978 conversion factor was 8.11 Mcf/bbl for Canadian production and 9.16 for United States production based on actual volumes and revenues.
- (5) Production commenced in January 1978.

Bow Valley Exploration

COAL

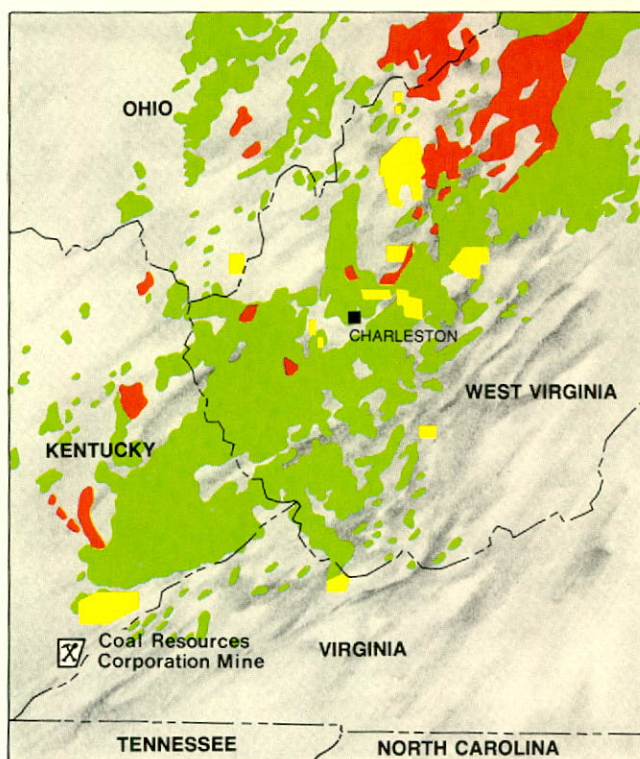
Bow Valley, through its recent acquisition of Flying Diamond Oil Corporation, conducts underground bituminous coal mining operations on an 8,000-acre tract in Harlan County, Kentucky. The operation is conducted by a wholly-owned subsidiary, Coal Resources Corporation, and production is a low sulphur, high quality steam and stoker coal. Approximately 85 percent of the current production is steam coal, which involves minimum preparation and is sold under long term contracts to southeastern utility companies for the generation of electricity. The remaining production is stoker coal, which is further processed and sold on spot contracts to industrial companies. Production for the five months ended May 31, 1978, was 455,000 tons, or 3,000 tons per day. Capital expenditures for the same period were \$489,000 and, in the seven months ending December 31, 1978, Bow Valley expects to spend an additional \$13,000,000. Recoverable coal reserves at May 31, 1978, as determined by independent consultants, were 27,439,000 measured tons.

During June 1978, additional recoverable coal reserves in excess of 7,000,000 measured tons were purchased on a 2,800-acre tract adjacent to the existing mine. Peak production from these new reserves will occur in 1980 and should amount to about 600,000 tons per year. Negotiations are in progress to sell additional coal on long term utility contracts.

The outlook for Bow Valley's coal operation is excellent; employee relations in the non-union mine are harmonious. The ten-year contracts that cover 75 percent of sales are protected with price escalation clauses.



Processed coal at a Coal Resources mining facility in eastern Kentucky.



Appalachian Basin

- BOW VALLEY LAND HOLDINGS
- BOW VALLEY COAL PROPERTY
- OIL FIELD
- GAS FIELD

URANIUM

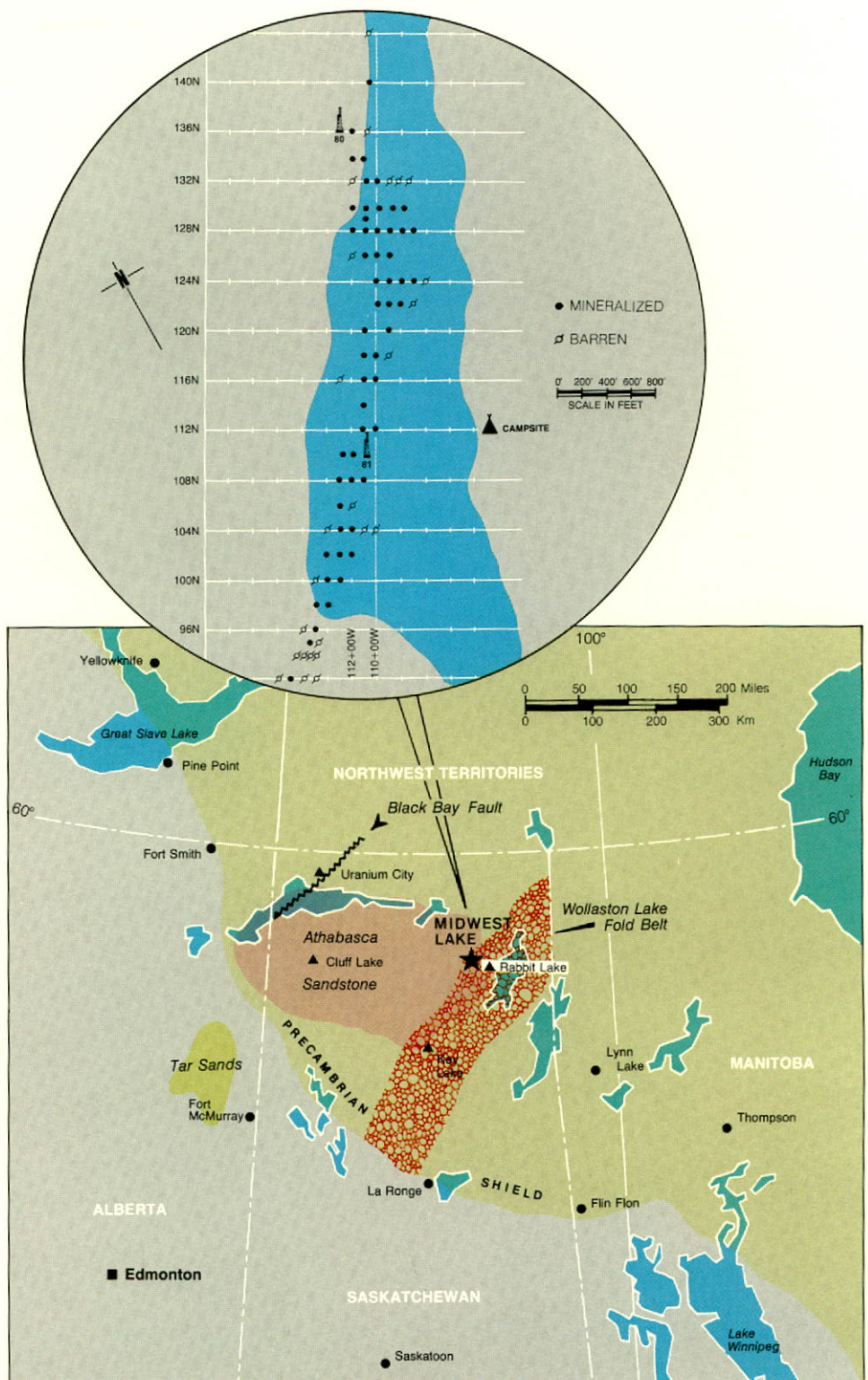
On February 20, 1978, Imperial Oil Limited announced that diamond drilling on a mineral prospect in northern Saskatchewan had encountered radioactivity. The announcement was of considerable importance to Bow Valley, which owns an initial 20 percent interest in the project.

The joint venture is on a 1,440-acre lease in the Midwest Lake area of northern Saskatchewan, 185 miles southeast of Uranium City and adjacent to Gulf Minerals' uranium mine at Rabbit Lake. Exploration in the area began in 1969; Bow Valley has been a continuous participant since that time and in fiscal 1978 had capital expenditures of \$250,000. Bow Valley's interest reduces to 12.5 percent after recovery of its initial investment.

At August 1, 1978, Imperial Oil, as operator, had drilled 79 core holes of a 105-core hole program. Two drills are being employed in the program: one operating on land and the other on a barge. Bow Valley's share of capital expenditures for the seven months ended December 31, 1978, is budgeted at \$200,000. The lake is 25 feet deep and the uranium occurs from the surface to a depth of 650 feet where the maximum mineralization exists. Although considerable coring remains to be done before the ore body is fully defined, it appears that:

- The length of the uranium ore body is over 4,000 feet and the approximate width 275 feet. The average thickness is about 50 feet.
- The average uranium content has been 37.5 pounds per ton, or 1.88 percent uranium oxide. Significant values of nickel and silver are also present.

The Saskatchewan government has recently concluded hearings on the uranium industry in the province and has determined that the industry



SASKATCHEWAN URANIUM PROJECT Midwest Lake Area

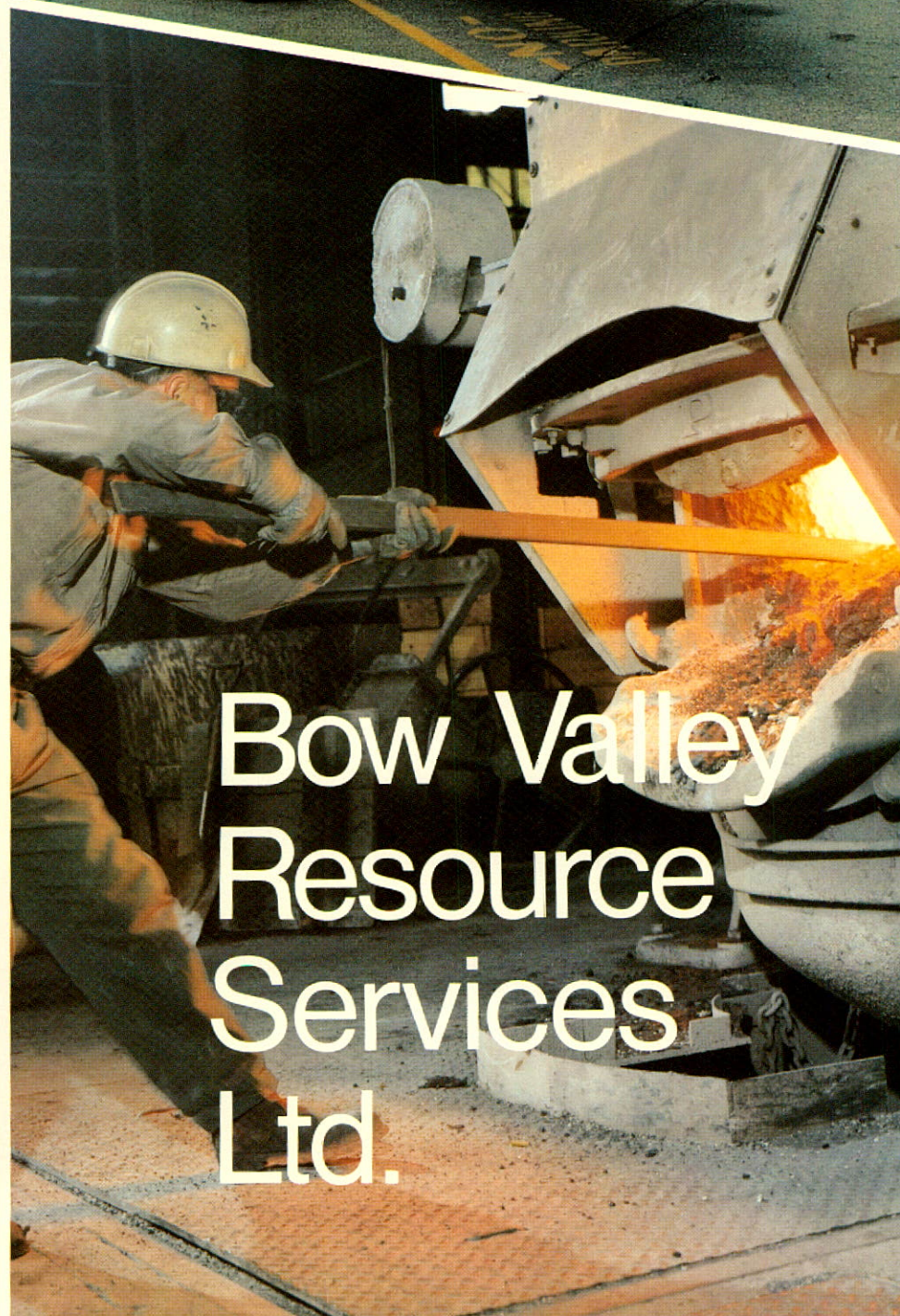
★ BOW VALLEY
URANIUM PROPERTY

should be allowed to proceed with development. Regulations have been established that should encourage an orderly and systematic development of the province's uranium reserves.

Bow Valley Exploration



Midwest Lake in northern Saskatchewan. Looking northeast the camp is onshore on the right while the offshore jack-up drill, which is one of the first such operations in Canada, is located on a barge in the lake.



Bow Valley
Resource
Services
Ltd.

All service and manufacturing operations of Bow Valley Industries Ltd. are conducted in a wholly-owned subsidiary company, Bow Valley Resource Services Ltd. The operations are primarily related to the natural resource industry and are administered in five groups according to their main areas of activity.

OILWELL DRILLING

The Oilwell Drilling Group achieved record results in fiscal 1978. Oilwell drilling activity in western Canada continued at a high level and increased contract drilling rates reflected the demand for drilling equipment. These factors, combined with an efficient operation, produced outstanding operating income. Government encouragement, through incentives and increased oil and gas prices, has stimulated the western Canadian petroleum industry to invest vigorously in exploration and development; this trend is expected to continue.

Bow Valley operates 36 oilwell drilling rigs in western Canada and in fiscal 1978 drilled 813 wells for a total of 2,678,038 feet. Comparative figures for fiscal 1977 were 776 wells for a total of 2,566,392 feet. During fiscal 1978, \$7,687,000 was spent on capital improvements.

Bow Valley is a 50 percent partner in a joint venture which operates four oilwell drilling rigs: two in the Arctic and two in Alberta. Activities were previously restricted to the Arctic Islands but attractive drilling opportunities in Alberta prompted a change in the location of the joint venture operation. In fiscal 1978, seven wells were drilled for a total of 59,319 feet versus only three wells drilled in fiscal 1977 for a total of 9,195 feet.

In the U.K. sector of the North Sea, Bow Valley has a 20 percent interest in a self-propelled, semi-submersible drilling rig. During fiscal 1978, the rig

was on a continuous contract in the Brae field and drilled four wells, although operating income was only minimal as contract drilling rates in the North Sea remained competitive.

In the Flying Diamond acquisition, Bow Valley acquired six oilwell

drilling rigs and related equipment in the Appalachian area of the eastern United States. These rigs have enjoyed a high rate of utility and are recording good profits.

The outlook for the Oilwell Drilling Group is excellent.



Bow Valley operates 36 oilwell drilling rigs in Canada, six in the United States, and has joint venture interests in another four rigs in Canada and in a semi-submersible rig in the North Sea.

OILFIELD SERVICES

The Oilfield Services Group, which provides a service and supply function to the oil and gas industry, had an increase in operating income in fiscal 1978 despite the disappointing results of the Construction Division. This division recorded a loss in excess of \$1,000,000 in fiscal 1978 and the operation is being discontinued.

The Helicopter Division enjoyed a high rate of activity in fiscal 1978 and all 20 helicopters were fully utilized. The demand for helicopters continues to be good.

The Oilfield Supply Division is closely related to the oilwell drilling operation and has benefited substantially from the increased level of exploration activity in western Canada. The five supply stores in Alberta and British Columbia anticipate a continuation of this favourable situation for some time to come.



Bow Valley's new 30-seat Sikorsky 61N helicopter, purchased for \$3,900,000, is now operating in a support role in the Beaufort Sea exploration program.

DIAMOND DRILLING

The Diamond Drilling Group suffered an operating loss of \$830,000 in fiscal 1978. Profit margins deteriorated during the year as conditions in the mining industry continued to be depressed because of low metal prices resulting from an oversupply of copper, lead, zinc, and other base metals. Companies servicing the mining industry are operating under very competitive conditions and certain reductions in overhead and branch operations have been necessary for Bow Valley to maintain its position in the industry.

Bow Valley is the largest diamond drilling contractor in Canada and operates 114 underground and 70 surface drills in Canada and the United States and has manufacturing facilities in Vancouver and Phoenix.

Base metal exploration activity is not expected to improve until base metal prices increase, although uranium and coal exploration is providing encouragement to the industry.

INDUSTRIAL PRODUCTS

The Industrial Products Group designs and manufactures machinery for the forest products, mining, and construction industries. A substantial improvement was recorded in operating results in fiscal 1978. The large losses of the previous two fiscal periods were reduced considerably and by the fiscal year end monthly profits were being reported. This favourable trend was occasioned by an efficient management team implementing cost control programs and accentuating the production and sale of higher margin items. Continued improvement is expected.

Facilities include a 160,000-square foot plant in Vancouver and seven warehouse locations across Canada and the United States.

ENVIRONMENTAL PRODUCTS

The Environmental Products Group includes a pollution control operation and manufacturing facilities for heating and air conditioning equipment. A good increase in operating income was recorded in fiscal 1978.

The Air Conditioning Products Division enjoyed an improvement in gross margin due to increased sales of commercial unit heaters. Production facilities consist of three manufacturing plants in Edmonton, totalling 105,000 square feet, with distribution centres in the three western provinces and in Ontario.

The Pollution Control Division had a general improvement in all areas of operation. Activities are administered from a 13,000-square foot laboratory and manufacturing facility in Calgary. The main areas of activity have been related to air monitoring services in gas and sulphur plants in Alberta.

Both divisions anticipate satisfactory profits in the following financial period.



Finance and Administration

Mangement's Discussion and Analysis of the Summary of Earnings

Fiscal 1978 Compared to Fiscal 1977

- Oil and gas revenue and income experienced a large increase in fiscal 1978 because of continued improvement in gas production and market prices. Coal sales commenced in January 1978 with significant contributions to revenue and income.
- Service and manufacturing revenue increased moderately but there was a substantial improvement in income. The Industrial Products Group recorded the most favourable change because of better economic conditions in the forest products industry and improved management controls. All other operating groups, with one exception, had income in excess of that earned the prior year.

Fiscal 1977 Compared to Fiscal 1976

- Oil and gas revenue and income increased substantially in fiscal 1977 because of higher gas production and improved market prices.
- Service and manufacturing revenue and income enjoyed a modest growth in fiscal 1977 as a result of the high level of oilfield activity in western Canada.

Fiscal 1976 Compared to Fiscal 1975

- Oil and gas revenue increased but additional bank interest expense and a loss on a joint venture service contract in the North Sea eliminated any improvement in year-end results.
- Service and manufacturing revenue increased moderately but income was lower because:
 - the Industrial Products Group had a large loss in fiscal 1976 as a result of depressed market conditions and numerous labour disputes in the forest products and mining industries.
 - the Oilfield Services Group's income decreased in fiscal 1976 due to cost escalations in the aviation services division and a substantial decrease in activity at the supply depot at Resolute Bay in the Arctic Islands.

These losses offset the gains recorded by the Oilwell Drilling Group.

Relative Contributions of Lines of Business

(Unaudited)

(Thousands of Canadian Dollars)

Years Ended May 31

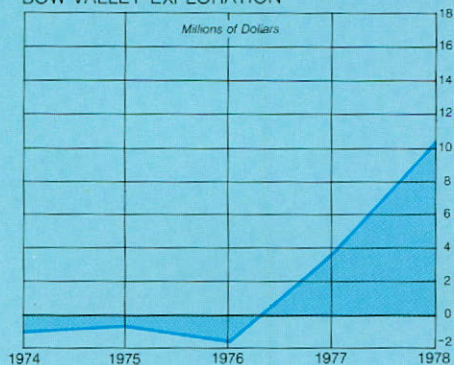
Revenue	1974		1975		1976		1977		1978	
Oil, gas and coal										
Oil and gas	\$ 3,427	5%	\$ 4,922	5%	\$ 7,229	7%	\$ 14,587	11%	\$ 26,635	15%
Coal	—	—	—	—	—	—	—	—	15,462	9
	3,427	5	4,922	5	7,229	7	14,587	11	42,097	24
Service and manufacturing										
Oilwell Drilling	20,186	28	19,666	21	26,867	26	34,079	26	47,666	27
Oilfield Services	18,436	25	26,245	28	24,181	23	31,968	24	31,039	18
Diamond Drilling	6,948	9	11,962	13	13,045	13	15,189	12	14,519	8
Industrial Products	19,160	26	23,887	25	24,277	24	25,215	19	25,362	15
Environmental Products	4,251	6	5,613	6	6,445	6	9,134	7	10,209	6
	68,981	94	87,373	93	94,815	92	115,585	88	128,795	74
Other	1,018	1	1,646	2	1,283	1	1,543	1	3,833	2
	<u>\$73,426</u>	<u>100%</u>	<u>\$93,941</u>	<u>100%</u>	<u>\$103,327</u>	<u>100%</u>	<u>\$131,715</u>	<u>100%</u>	<u>\$174,725</u>	<u>100%</u>

Income Before Income Taxes and Extraordinary Items

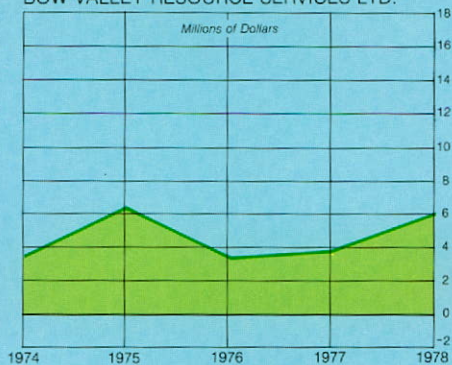
Oil, gas and coal										
Oil and gas	\$(1,071)	(36)%	\$ (861)	(13)%	\$(1,677)	(70)%	\$ 3,923	48 %	\$ 7,617	44 %
Coal	—	—	—	—	—	—	—	—	2,717	16
	(1,071)	(36)	(861)	(13)	(1,677)	(70)	3,923	48	10,334	60
Service and manufacturing										
Oilwell Drilling	1,284	43	2,156	35	4,039	169	5,002	62	5,750	34
Oilfield Services	(183)	(6)	1,880	30	426	18	67	1	392	2
Diamond Drilling	705	24	979	16	318	13	53	1	(830)	(5)
Industrial Products	1,418	48	835	13	(1,490)	(62)	(1,636)	(20)	(212)	(1)
Environmental Products	133	4	373	5	92	4	397	5	933	5
	3,357	113	6,223	99	3,385	142	3,883	49	6,033	35
Other	697	23	879	14	676	28	272	3	962	5
	<u>\$ 2,983</u>	<u>100%</u>	<u>\$ 6,241</u>	<u>100%</u>	<u>\$ 2,384</u>	<u>100%</u>	<u>\$ 8,078</u>	<u>100%</u>	<u>\$17,329</u>	<u>100%</u>

INCOME BEFORE INCOME TAXES AND EXTRAORDINARY ITEMS

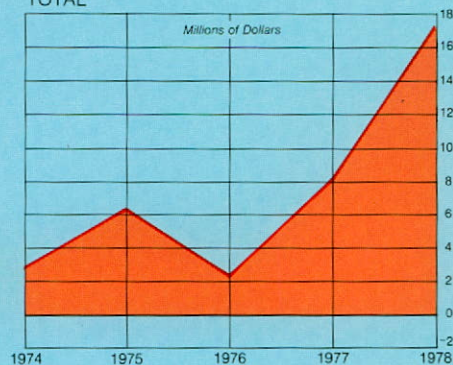
BOW VALLEY EXPLORATION



BOW VALLEY RESOURCE SERVICES LTD.



TOTAL

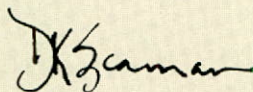


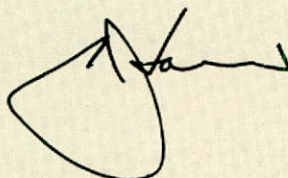
Consolidated Balance Sheet

(Canadian Dollars)

	May 31	
	1978	1977
Assets		
Current assets:		
Accounts receivable	\$ 41,799,000	\$ 29,399,000
Inventories (Note 3)	19,710,000	15,612,000
Prepaid expenses	2,208,000	1,009,000
	<u>63,717,000</u>	<u>46,020,000</u>
Capital assets, at cost less accumulated		
depreciation and depletion (Note 4)	290,639,000	92,786,000
Other assets:		
Real estate held for resale, at cost	4,715,000	—
Mortgages and deferred receivables, less		
current portion	2,951,000	195,000
Interest in foreign partnership, at equity value	2,718,000	3,040,000
Investments in and advances to other companies		
and sundry assets, at cost	5,548,000	3,722,000
Goodwill, at cost less amounts amortized	3,513,000	4,772,000
	<u>19,445,000</u>	<u>11,729,000</u>
	<u>\$373,801,000</u>	<u>\$150,535,000</u>

Approved by the Board:

 Director

 Director

	May 31	
	1978	1977
Liabilities		
Current liabilities:		
Bank loans and bankers' acceptances, including cheques issued, at 9.5%, secured (Note 5)	\$ 7,683,000	\$ 12,486,000
Accounts payable and accrued	34,272,000	18,820,000
Long term debt due within one year	10,273,000	3,491,000
	<u>52,228,000</u>	<u>34,797,000</u>
Long term debt (Note 6)	218,752,000	46,698,000
Exploration and development advances (Note 7)	19,412,000	11,888,000
Other liabilities	1,208,000	1,637,000
Deferred income taxes	35,964,000	19,516,000
Shareholders' equity (Note 8):		
Share capital	28,383,000	27,867,000
Retained earnings	17,854,000	8,132,000
	<u>46,237,000</u>	<u>35,999,000</u>
Contingent liabilities and commitments (Note 11)		
	<u>\$373,801,000</u>	<u>\$150,535,000</u>

Consolidated Statement of Income

(Canadian Dollars)

	Year ended May 31	
	1978	1977
Revenue:		
Service and manufacturing	\$128,795,000	\$115,585,000
Oil, gas and coal, less royalties	42,097,000	14,587,000
Other	3,833,000	1,543,000
	<u>174,725,000</u>	<u>131,715,000</u>
Expenses:		
Direct costs	113,355,000	94,366,000
Depreciation, depletion and amortization	15,674,000	7,987,000
General and administrative	17,945,000	14,719,000
Interest on long term debt	9,029,000	5,190,000
Other interest	1,393,000	1,375,000
	<u>157,396,000</u>	<u>123,637,000</u>
Income before income taxes	17,329,000	8,078,000
Income taxes (Note 9):		
Current	1,437,000	1,240,000
Deferred	5,003,000	2,060,000
	<u>6,440,000</u>	<u>3,300,000</u>
Net income	\$ 10,889,000	\$ 4,778,000
Net income per common share:		
Basic	<u>\$2.13</u>	<u>\$0.87</u>
Fully diluted	<u>\$2.07</u>	<u>\$0.87</u>

Consolidated Statement of Retained Earnings

(Canadian dollars)

	Year ended May 31	
	1978	1977
Balance at beginning of year (Note 8)	\$ 8,132,000	\$ 4,383,000
Add:		
Net income for the year	10,889,000	4,778,000
Contributed surplus arising on redemption of series A preferred shares	13,000	32,000
	<u>19,034,000</u>	<u>9,193,000</u>
Deduct:		
Dividends paid —		
5½% preferred shares series A	74,000	78,000
5% second preference shares	500,000	500,000
Common shares (\$0.125 per share, 1977 - \$0.10)	606,000	483,000
	<u>1,180,000</u>	<u>1,061,000</u>
Balance at end of year (Note 8)	<u>\$17,854,000</u>	<u>\$ 8,132,000</u>

Consolidated Statement of Changes in Financial Position

(Canadian dollars)

	Year ended May 31	
	1978	1977
Source of working capital:		
From operations —		
Net income	\$ 10,889,000	\$ 4,778,000
Add: Non-cash items	18,809,000	9,772,000
	<u>29,698,000</u>	<u>14,550,000</u>
Long term debt issued	160,853,000	16,723,000
Exploration and development advances	7,524,000	11,888,000
Share capital issued	573,000	205,000
Other	705,000	438,000
	<u>199,353,000</u>	<u>43,804,000</u>
Application of working capital:		
Additions to capital assets —		
Oil, gas and coal properties and equipment	34,728,000	22,981,000
Drilling, helicopters and other equipment	16,302,000	11,498,000
	<u>51,030,000</u>	<u>34,479,000</u>
Less: Proceeds of disposals	3,336,000	12,135,000
	<u>47,694,000</u>	<u>22,344,000</u>
Acquisition of Flying Diamond Oil Corporation, less working capital acquired (Note 2)	135,005,000	—
Repayment of long term debt and change in current portion	11,841,000	11,156,000
Dividends paid	1,180,000	1,061,000
Other	3,367,000	1,135,000
	<u>199,087,000</u>	<u>35,696,000</u>
Increase in working capital	266,000	8,108,000
Working capital at beginning of year	11,223,000	3,115,000
Working capital at end of year	<u>\$ 11,489,000</u>	<u>\$ 11,223,000</u>

Notes to Consolidated Financial Statements

May 31, 1978

1. Summary of accounting policies:

These consolidated financial statements are prepared in conformity with accounting principles generally accepted in Canada. The significant policies are presented below.

Principles of consolidation —

The consolidated financial statements include Bow Valley Industries Ltd. and its subsidiaries ("Bow Valley") as well as Bow Valley's interest in partnerships, some of which are limited partnerships in which Bow Valley is the general partner. A 20% foreign partnership interest is accounted for by the equity method, and the results of its operations are included in other income in the consolidated financial statements on the basis of its December 31, 1977 year end financial statement.

Foreign currency translation —

For purposes of translating foreign currency transactions and accounts of foreign subsidiaries to Canadian dollars, Bow Valley follows the method recommended by the Canadian Institute of Chartered Accountants. Under this method:

- Monetary assets and liabilities (cash, mortgages and accounts receivable, current liabilities and long-term debt) are translated at year-end rates.
- Non-monetary assets and liabilities (inventories, prepaid assets, capital assets, real estate held for resale, investments and sundry assets, deferred income taxes and exploration and development advances) are translated at rates in effect on the dates of the transactions (historical rates).
- Most revenues and expenses are translated at average rates in effect during the year. Certain expenses such as depreciation, depletion and some direct costs which relate to non-monetary assets, are translated at historical rates. The resulting gains and losses are reflected immediately in the statement of income except for unrealized translation gains and losses relating to long term debt. At May 31, 1978 unrealized exchange losses of \$1,066,000 (1977 — \$NIL) were deferred for subsequent amortization.

Capital assets, depreciation and depletion —

(a) Oil and gas properties:

Bow Valley follows the full cost method of accounting for oil and gas operations whereby all costs of exploring for and developing oil and gas reserves are capitalized and charged against earnings as set out below. Such costs include land acquisition costs, geological and geophysical expense, carrying charges of non-producing properties, costs of drilling both productive and non-productive wells and overhead expense related to exploration activities. The costs are accumulated in cost centres as follows —

- (i) Canada — Excluding areas North of 60°N and offshore.
- (ii) Frontier Canada — North of 60°N and offshore.
- (iii) United States — Including offshore.
- (iv) Europe — United Kingdom and Continental Europe including its Continental Shelf which encompasses all sectors of the North Sea, Celtic Sea and English Channel.
- (v) North Africa and the Middle East — Encompassing Abu Dhabi, Iraq, Iran, Saudi Arabia, Egypt and adjacent areas.
- (vi) Other Areas — A separate cost centre is established for each additional foreign area in which Bow Valley is engaged in exploration activities.

Costs accumulated in producing cost centres (at present only Canada and United States) are depleted using the unit of production method based upon estimated proven reserves of oil and gas. In calculating depletion, natural gas, natural gas liquids and sulphur reserves and production are converted to equivalent barrels of crude oil based on the relative net sales value of each product.

Expenditures in non-producing cost centres are amortized by the straight-line method over ten years or until sufficient reserves are established to warrant economically commercial production, at which time amortization ceases. When production commences, costs are depleted by the unit of production method. If exploration is discontinued in a cost centre the unamortized costs in that area are charged immediately against income (included in depletion).

Gains or losses on the sale or disposition of oil or gas properties held for development purposes, are not ordinarily reflected in net income except in cases of major disposals of reserves.

(b) Other capital assets:

Depreciation of oil and gas well equipment is calculated by the straight-line method mainly at the rate of 10% for the Canadian operations and by the unit of production basis for the United States operations; oilwell drilling and related equipment by the diminishing balance method, mainly at the rate of 20%; helicopters and related equipment by the straight-line method, mainly at the rate of 10% of cost less an estimated residual value equal to 40% of cost; other capital assets by the diminishing balance method at various rates. The cost of coal properties is depleted by the unit of production method and related equipment is depreciated by the straight-line method at the rate of 10%.

Capitalization of interest —

Interest on debt specifically obtained for the construction or development of major capital assets is capitalized until the assets commence operations. During 1978, interest of \$1,640,000 was capitalized (1977 — \$435,000).

2. Acquisition of Flying Diamond Oil Corporation:

During the period January 6, 1978 to May 31, 1978, Bow Valley acquired 100% ownership of Flying Diamond Oil Corporation ("Flying Diamond"), a Utah corporation. Flying Diamond is primarily involved in oil, gas and coal exploration and development in the United States and to a lesser extent in contract oilwell drilling, pipeline services and real estate development in the United States.

The acquisition has been accounted for using the purchase method. Bow Valley's share of Flying Diamond's operating results during the acquisition period have been reflected in these consolidated financial statements.

The assets acquired and cost to Bow Valley are summarized as follows:

Working capital		\$ 10,149,000
Capital assets:		
Oil and gas properties and equipment	\$95,232,000	
Coal properties and equipment	57,286,000	
Drilling, pipeline and other equipment	10,038,000	
		162,556,000
Other assets and deferred charges		10,097,000
		182,802,000
Deduct liabilities assumed:		
Long term debt	23,069,000	
Deferred income taxes	11,732,000	
Other	2,847,000	
		37,648,000
Purchase consideration, payable in cash, for net assets acquired		\$145,154,000

The excess of the purchase consideration over Flying Diamond's net book value has been allocated to capital assets. Note 11 contains a summary of litigation outstanding against Flying Diamond at the date of acquisition. Settlements, if any, will be reflected as additional excess purchase consideration requiring a retroactive adjustment to depreciation and depletion expense.

3. Inventories:

Inventories, which are valued at the lower of cost or net realizable value, consist of the following —

	1978	1977
Finished and resale goods	\$ 8,320,000	\$ 7,025,000
Work in progress	1,246,000	1,212,000
Raw materials	2,654,000	2,772,000
Materials and supplies	7,490,000	4,603,000
	<u>\$19,710,000</u>	<u>\$15,612,000</u>

4. Capital assets:

	1978		1977	
	Cost	Net Book Value	Cost	Net Book Value
Oil and gas properties and equipment	\$215,199,000	\$190,611,000	\$ 85,887,000	\$ 67,127,000
Coal properties and equipment	57,775,000	55,660,000	—	—
Drilling and related equipment	43,008,000	25,001,000	27,894,000	13,015,000
Other capital assets	29,938,000	19,367,000	22,358,000	12,644,000
	<u>\$345,920,000</u>	<u>\$290,639,000</u>	<u>\$136,139,000</u>	<u>\$ 92,786,000</u>

Depreciation and depletion charged during fiscal 1978 were \$9,152,000 and \$6,465,000 (1977 — \$5,759,000 and \$2,125,000), respectively, and the related accumulated balances at May 31, 1978 were \$35,551,000 and \$19,730,000 (1977 — \$28,993,000 and \$14,360,000).

5. **Bank loans and bankers' acceptances:**

Bank loans and bankers' acceptances are secured by a \$2,000,000 floating charge demand debenture on the current assets of a subsidiary and various chattel mortgages. In addition, Bow Valley has granted the bank general assignments of accounts receivable and pledged certain inventories under Section 88 of the Bank Act. There are no specific repayment terms for short term bank indebtedness.

Bow Valley has an established line of credit with their bankers which covers short term bank borrowings of which approximately \$4.8 million was unused at May 31, 1978. Bow Valley has an unused line of credit related to long term borrowings amounting to \$6.8 million.

6. **Long term debt:**

	1978	1977
* Bank loans to acquire Flying Diamond Oil Corporation, at the bank's prime rate plus $\frac{3}{4}\%$ and 1% increasing over the term of the loans to $1\frac{3}{4}\%$ and $1\frac{1}{4}\%$ respectively, secured by certain oil and gas properties and subsequently by an assignment of the shares of Flying Diamond (including \$76,441,000 U.S.)	\$140,752,000	\$ —
* Bank production loans, at bank prime plus $\frac{3}{4}\%$ of 1%, secured by assignments on certain oil and gas properties (including \$12,000,000 U.S.)	48,272,000	33,795,000
* Bank loans, at bank prime plus $1\frac{1}{4}\%$ to 2%, secured by chattel mortgages on buildings and equipment (including \$1,162,000 U.S.)	15,579,000	12,248,000
** 7% Sinking Fund Debentures, Series A, due March 1, 1986.	2,079,000	2,241,000
9 $\frac{1}{4}\%$ promissory note due December, 1991 (\$15,000,000 U.S.)	16,827,000	—
Other (including \$2,263,000 U.S.)	5,516,000	1,905,000
Total long term debt (including \$106,866,000 U.S.)	229,025,000	50,189,000
Less: Amount due within one year	10,273,000	3,491,000
	<u>\$218,752,000</u>	<u>\$ 46,698,000</u>

* Terms of these loans provide for repayments over varying periods of time extending to 1987; however, the banks reserve the right to call loans amounting to \$90 million on demand.

** Redeemed subsequent to year end out of proceeds of additional long term bank loans.

The aggregate repayments on long term debt in each of the next five years are: 1979 — \$10,273,000; 1980 — \$19,288,000; 1981 — \$21,524,000; 1982 — \$23,779,000 and 1983 — \$22,355,000.

7. **Exploration and development advances:**

Bow Valley receives advances bearing annual interest of $6\frac{3}{4}\%$ in connection with the exploration and development of the Brae field in the U.K. North Sea. The advances and interest are payable solely out of 70% of Bow Valley's share of net proceeds of production from the Brae field when and only if commercial production is obtained.

8. Shareholders' equity:

(a) Share capital — authorized and issued —

	1978	1977
5½% cumulative redeemable preferred shares series A of a par value of \$20 each —		
Authorized and issued — 100,000 shares		
Outstanding — 65,600 shares (1977 — 68,450 shares)	\$ 1,312,000	\$ 1,369,000
5% cumulative redeemable convertible second preference shares of a par value of \$100 each —		
Authorized, issued and outstanding — 100,000 shares	10,000,000	10,000,000
Common shares of no par value —		
Authorized — 7,000,000 shares		
Issued and outstanding — 4,868,336 shares (1977 — 4,838,036 shares)	17,071,000	16,498,000
	<u>\$28,383,000</u>	<u>\$27,867,000</u>

Bow Valley is required to expend \$40,000 per year (or such lesser amount as would increase the fund to \$80,000) on a purchase fund for the redemption or retirement of its series A preferred shares, provided such shares are available in the open market for purchase at a price not exceeding their par value plus reasonable cost of acquisition. These shares are subject to redemption at any time at \$21 per share. On liquidation, dissolution or winding up they rank prior to the common and second preference shares and holders are entitled to receive \$21 per share plus accrued unpaid dividends.

The second preference shares are convertible at any time prior to April 2, 1979, into common shares at an initial conversion price of \$30 per common share (3⅓ common shares for one preference share). These shares rank junior to the series A preferred shares and are subject to redemption at \$105 per share, plus accumulated unpaid dividends, except that during the period to April 1, 1979 redemptions are subject to deferral under certain conditions. On or before March 31 of each year, commencing in 1980, Bow Valley is required to set aside a sinking fund equal to 5% of the par value of the second preference shares outstanding on April 1, 1979 for the purpose of redeeming or purchasing the shares.

In fiscal 1978, 30,300 common shares (1977 — 11,710) were issued for a cash consideration of \$573,000 (1977 — \$205,000) upon exercise of employee stock options.

(b) Common shares unissued —

Of the authorized but unissued common shares, 452,088 were reserved at May 31, 1978 for the following:

- (i) 118,755 for options granted, or available for granting, to officers and employees of Bow Valley under the terms of Bow Valley's Incentive Stock Option Plan. At May 31, 1978, 99,400 options were outstanding with option prices ranging from \$15.08 to \$25.18 per share for a potential consideration of \$1,928,000. Options are exercisable within five years from the date of grant.
- (ii) 333,333 for conversion of the second preference shares.

(c) Retained earnings and dividend restrictions —

Included in retained earnings, and reclassified retroactively, are contributed surplus and a capital redemption reserve fund amounting to \$205,000 and \$688,000 (1977 — \$192,000 and \$631,000), respectively. Both items result from redemption of the series A preferred shares.

Under the terms of the series A preferred shares, dividends on common shares can not be declared or paid unless, after giving effect to such dividends, the amount of the consolidated retained earnings will be at least 125% of the par value of all the series A preferred shares and all preferred shares ranking in priority thereto or equally therewith then issued and outstanding.

At May 31, 1978 approximately \$16.2 million of the consolidated retained earnings were free of this restriction.

The Company is also subject to dividend restrictions until October 13, 1978 under the Canadian anti-inflation program.

9. Income taxes:

In fiscal 1978, total tax expense recorded in the financial statements amounted to \$6,440,000 (an effective rate of 37.2%) which is less than the amount of \$8,145,000 computed by applying the Canadian corporate tax rate for the year ended May 31, 1978 of 47% to income before provision for income taxes.

In fiscal 1977, total tax expense recorded in the financial statements amounted to \$3,300,000 (an effective rate of 40.9%) which is less than the amount of \$3,797,000 computed by applying the Canadian corporate tax rate for the year ended May 31, 1977 of 47% to income before provision for income taxes.

These differences are explained as follows:

	1978	1977
Computed income tax expense	\$ 8,145,000	\$ 3,797,000
Add (deduct):		
Crown charges disallowed for tax purposes	4,625,000	3,099,000
Resource profits rate reductions	(5,443,000)	(3,013,000)
Provincial resource industry rebates	(1,521,000)	(1,255,000)
Other	634,000	672,000
Tax expense reflected in the accounts	<u>\$ 6,440,000</u>	<u>\$ 3,300,000</u>

The deferred income tax expense of \$5,003,000 (1977 — \$2,060,000) results from timing differences in the recognition of revenues and expenses for tax and financial statement purposes. The main components of these differences, and the tax effect thereof, are as follows:

	1978	1977
Excess of capital cost allowance for tax purposes over depreciation	\$ 1,780,000	\$ 1,411,000
Excess of drilling and exploration expenditures for tax purposes over depletion	2,910,000	568,000
Other	313,000	81,000
	<u>\$ 5,003,000</u>	<u>\$ 2,060,000</u>

At May 31, 1978, subsidiary companies had tax losses of \$910,000, which expire at varying dates to 1985, available to carry forward against future taxable income. No provision has been made in the accounts for possible future tax benefits which may arise from these losses.

10. Remuneration of directors and senior officers:

During fiscal 1978, there were 11 directors and 8 officers of whom 5 were also directors (1977 — 11 directors and 13 officers of whom 5 were also directors). Directors' fees and officers' remuneration for the year amounted to \$26,000 and \$555,000 respectively (1977 — \$25,000 and \$791,000 respectively). Officers who are also directors receive no remuneration in their capacity as directors.

11. Contingent liabilities and commitments:

At May 31, 1978 Bow Valley was contingently liable as follows:

- (a) For the liabilities of co-owners in joint ventures and partnerships, against which Bow Valley would have a claim against the other co-owners and the interest of the co-owners in the joint venture and partnership assets.
- (b) As guarantor of the indebtedness of third parties and discounted conditional sales contracts in the amount of approximately \$3.4 million.
- (c) As defendant in certain lawsuits against Flying Diamond Oil Corporation, a subsidiary —
 - (i) Flying Diamond is a defendant in a suit commenced in August, 1977, alleging that in 1975, Flying Diamond overcharged the plaintiff approximately \$250,000 U.S. in relation to the then lawful prices for crude oil as fixed by the U.S. Federal Energy Administration; Flying Diamond failed to perform under an oil supply contract resulting in an additional loss to the plaintiff of \$150,000 U.S.; and Flying Diamond used oppressive and unlawful methods in collecting the alleged unlawful overcharges, resulting in damages to the plaintiff in excess of \$17 million U.S., including \$15 million U.S. representing the discounted value of lost profits.
Discovery procedures have not yet been completed. However, in the opinion of management and legal counsel, the \$15 million U.S. item is of questionable merit and the probability that Bow Valley will sustain a material loss as a result of it is not likely.
 - (ii) On December 23, 1977, an action for damages in excess of \$2,800,000 U.S. was filed in the United States District Court for the Southern District of New York against certain named defendants including Flying Diamond, alleging violations of the Securities and Exchange Acts in connection with the offer and sale to plaintiff of interests in nine limited partnerships formed by Flying Diamond. In addition, the complaint alleges that Flying Diamond, among other things, breached the limited partnership agreements and fiduciary duties and violated the General Business Law of the State of New York. Flying Diamond considers the suit without merit and has filed an answer denying the substantive allegations in the complaint and asserting affirmative defences.
 - (iii) On August 11, 1978, a class action complaint was filed in the United States District Court, for the Southern District of New York, alleging violation of the Securities Exchange Act and other matters seeking judgement against the named defendants, including Flying Diamond and Bow Valley, in favor of the class for damages sustained, punitive damages and plaintiff's costs in prosecuting the suit. The complaint alleges, among other things, inadequate disclosure relating to the value of the Flying Diamond shares. Bow Valley's legal counsel believes that settlement, if any, will not be material.

12. Quarterly financial information (unaudited):

	Year Ended May 31	
	1978	1977
Revenue:		
First quarter	\$ 37,436,000	\$ 32,948,000
Second quarter	38,335,000	33,392,000
Third quarter	*44,849,000	31,781,000
Fourth quarter	54,105,000	33,594,000
	<u>\$174,725,000</u>	<u>131,715,000</u>
Net income:		
First quarter	\$ 2,262,000	\$ 967,000
Second quarter	2,662,000	421,000
Third quarter	1,660,000	1,549,000
Fourth quarter	4,305,000	1,841,000
	<u>\$ 10,889,000</u>	<u>\$ 4,778,000</u>
Per common share:		
First quarter	\$ 0.44	\$ 0.17
Second quarter	0.52	0.06
Third quarter	0.31	0.29
Fourth quarter	0.86	0.35
	<u>\$ 2.13</u>	<u>\$ 0.87</u>

*The third quarter revenue as filed on Form 10-Q with the Securities and Exchange Commission in Washington, D.C. was \$36,456,000. The amount above has been restated to reflect Flying Diamond's revenue from January 6, 1978.

13. Other information:

The Securities and Exchange Commission of the United States requires disclosure of other information and comments on the impact of accounting principles used which do not conform with those generally accepted in the United States. This information is presented in Bow Valley's 1978 Form 10-K which will be filed with the Commission in Washington, D.C. and will be available to shareholders upon request.

Bow Valley follows generally accepted accounting principles in Canada and the principal differences from U.S. generally accepted accounting principles are as follows:

- Unrealized foreign exchange losses deferred for subsequent amortization (as disclosed in Note 1) would be charged to expense currently under U.S. practice and this would result in a reduction in net income of \$1,066,000 (\$0.22 per share).
- The results of operations of the newly acquired subsidiary, Flying Diamond, have been included since its acquisition. Had the accounts been consolidated throughout the two years ended May 31, 1978, taking into account the effect of increased borrowing costs in connection with the acquisition and additional depreciation and depletion for the increased basis of fixed assets acquired net of applicable income taxes, the unaudited pro-forma results would have been as follows: consolidated revenue — \$211,629,000 (1977 — \$177,539,000); net income for the year — \$7,267,000 (1977 — Loss of \$2,537,000); earnings per share — \$1.38 per share (1977 — Loss of \$0.64 per share).

Auditors' Report

To the Shareholders of
BOW VALLEY INDUSTRIES LTD.

We have examined the consolidated balance sheet of Bow Valley Industries Ltd. as at May 31, 1978 and the consolidated statements of income, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at May 31, 1978 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles in Canada applied on a basis consistent with that of the preceding year.

Calgary, Alberta
August 11, 1978

Price Waterhouse & Co.
Chartered Accountants

Five Year Summary

May 31, 1978 (Thousands of Canadian dollars, except for per share amounts)

	1978	1977	1976	1975	1974
Revenue	\$174,725	\$131,715	\$103,328	\$ 93,941	\$ 73,426
Costs and expenses					
Direct costs	113,355	94,366	76,207	67,055	54,230
General and administrative	17,945	14,719	12,978	11,125	8,181
Depreciation, depletion and amortization	15,674	7,987	6,270	5,700	5,536
Interest — On long term debt	9,029	5,190	4,138	2,766	1,669
— Other	1,393	1,375	1,351	1,054	827
	157,396	123,637	100,944	87,700	70,443
	17,329	8,078	2,384	6,241	2,983
Taxes on income					
Current	1,437	1,240	146	834	449
Deferred	5,003	2,060	1,263	2,827	1,207
	6,440	3,300	1,409	3,661	1,656
Income before extraordinary items	10,889	4,778	975	2,580	1,327
Extraordinary items	—	—	—	277	—
Net income	\$ 10,889	\$ 4,778	\$ 975	\$ 2,857	\$ 1,327
Deduct — Preferred share dividend requirements	574	578	581	586	589
Net income applicable to common shares	\$ 10,315	\$ 4,200	\$ 394	\$ 2,271	\$ 738
Weighted average shares outstanding	4,843,004	4,833,725	4,794,668	4,771,822	4,768,873
PER COMMON SHARE					
Income before extraordinary items	\$ 2.13	\$ 0.87	\$ 0.08	\$ 0.42	\$ 0.15
Extraordinary items	—	—	—	0.06	—
Net income	\$ 2.13	\$ 0.87	\$ 0.08	\$ 0.48	\$ 0.15
Dividends per share					
Common	\$ 0.125	\$ 0.10	\$ 0.10	\$ 0.10	\$ 0.10
Preferred, series A	1.10	1.10	1.10	1.10	1.10
Second preference	5.00	5.00	5.00	5.00	5.00

Shareholders Information

Stock Price

The following table indicates the quarterly high bid and low bid prices for the common stock of Bow Valley on The Toronto Stock Exchange for the last two years.

	Fiscal 1978		Fiscal 1977	
First Quarter	\$22 ⁷ / ₈	17 ⁵ / ₈	27 ¹ / ₂	22 ¹ / ₈
Second Quarter	21 ³ / ₄	17 ⁵ / ₈	25 ¹ / ₄	18 ¹ / ₄
Third Quarter	23 ³ / ₄	20 ¹ / ₈	24 ¹ / ₂	19 ¹ / ₈
Fourth Quarter	30 ⁵ / ₈	21 ⁵ / ₈	21	16

Common Shareholder Distribution — May 31, 1978

	Number of Shares	Percent
Canada	3,164,400	65
United States	1,557,860	32
Other	146,076	3
	4,868,336	100

Directors

FREDERIC J. AHERN, Vice-President,
Baldwin-United Corporation, New York
R. GUY GODBOUT, President, Les Industries
Valcartier Inc., Montreal
JAMES S. GRAHAM, Industrialist, Vancouver
J. RICHARD HARRIS, President, Bow Valley
Industries Ltd., Calgary
MAJOR GENERAL LORD MICHAEL FITZALAN
HOWARD, KCVO, CB, CBE, MC, DL, Marshal
of the Diplomatic Corps, London
WILLIAM A. HOWARD, QC, Barrister and
Solicitor, Calgary
BYRON J. SEAMAN, Vice-Chairman of the
Board, Bow Valley Industries Ltd., Calgary
DARYL K. SEAMAN, Chairman of the Board,
Bow Valley Industries Ltd., Calgary
DONALD R. SEAMAN, Senior Vice-President,
Bow Valley Industries Ltd., Calgary
D'ALTON L. SINCLAIR, Financial Consultant,
Toronto

Officers

DARYL K. SEAMAN, Chairman of the Board
and Chief Executive Officer
BYRON J. SEAMAN, Vice-Chairman of the
Board
J. RICHARD HARRIS, President and Chief
Operating Officer
DONALD R. SEAMAN, Senior Vice-President
FREDERIC J. WELLHAUSER, Senior
Vice-President
ROBERT J. PHIBBS, Vice-President,
Administration
H. KEITH LAZELLE, Vice-President and
Secretary
TREVOR A. LEGGE, Vice-President, Treasurer
and Controller

Corporate

Head Office

1500, 630 Sixth Avenue SW, Calgary T2P 2V8
Telephone: 231-1211
Telex: 24692

Foreign Offices

BOW VALLEY EXPLORATION (U.S.) INC.
1700 Broadway, Denver, Colorado, 80290
Telephone: 861-4366

BOW VALLEY EXPLORATION (U.K.) LIMITED
Lex House
3/5 Burlington Gardens
London W1X 1L3
Telephone: 734-3666
Telex: 23688

BOW VALLEY EXPLORATION (SINGAPORE)
PTE. LTD.
1502 - 1503 Goldhill Plaza
Newton Road
Singapore 11
Telephone: 252-2160
Telex: 8724414

Transfer Agents

Common Stock
GUARANTY TRUST COMPANY OF
CANADA, Calgary, Toronto, and Vancouver
THE BANK OF NEW YORK, New York

Preferred Stock, Series A
THE ROYAL TRUST COMPANY, Calgary,
Winnipeg, Toronto, and Montreal

Second Preference Shares
THE ROYAL TRUST COMPANY, Calgary

Registrars

Common Stock
GUARANTY TRUST COMPANY OF
CANADA, Calgary, Toronto, and Vancouver
THE BANK OF NEW YORK, New York

Preferred Stock, Series A
GUARANTY TRUST COMPANY OF
CANADA, Calgary, Winnipeg, Toronto, and
Montreal

Second Preference Shares
THE ROYAL TRUST COMPANY, Calgary

Stock Exchange Listings — Common Shares

Toronto Stock Exchange
American Stock Exchange
London Stock Exchange (Section 163(1)E)

Auditor

PRICE WATERHOUSE & CO.

Legal Counsel

HOWARD, DIXON, MACKIE, FORSYTH,
Calgary
PAUL, WEISS, RIFKIND, WHARTON &
GARRISON, New York
TEACHER, STERN, HUNTER & SELBY, London

Banker

THE ROYAL BANK OF CANADA

Annual General Meeting

The Annual General Meeting of the
Shareholders of Bow Valley Industries Ltd. will
be held in Calgary in the Bel Aire Room of the
Calgary Inn at 10:00 a.m., September 29,
1978.

